RISKY INVESTMENTS

A Practical Guide For Protecting Your Investment Dollars



About the Division Of Business Registration

The sale of securities in Hawaii is regulated by the Division of Business Registration, a part of the Department of Business & Consumer Affairs. The Commissioner of Securities oversees the three branches of this division: Documents Registration, Securities Compliance and Securities Enforcement.

The Documents Registration Branch administers the business registry related to corporations, partnerships, limited liability companies, limited liabilities partnerships, tradenames, trademarks, and service marks.

The Securities Compliance Branch conducts licensing, securities registration, and examinations.

The Securities Enforcement Branch receives and investigates complaints and inquiries regarding individuals and entities.

The Office of the Commissioner of Securities sponsors a Securities Education Program, established to help prevent investor fraud. Investors in Hawaii with complaints or questions relating to securities transactions should contact:

DEPARTMENT OF COMMERCE & CONSUMER AFFAIRS Office of the Commissioner of Securities Securities Enforcement Branch 1010 Richards Street Honolulu, Hawaii 96813 (808) 586-2740 (808) 586-3977 Fax

INVESTIGATE BEFORE YOU INVEST

In today's complex financial world, there are many investment opportunities. Potential investors find themselves solicited by telephone calls, mailings, and even through their computer information systems. Some investment opportunities hold great promise of financial return; others do not.

No matter how you choose to invest your money, a degree of risk exists. The greater the "promise" of a return, the riskier the investment. Often, the investment that sounds like a sure winner is the invention of a con artist and should be avoided altogether.

Each year, investors in Hawaii lose millions of dollars to securities and commodities fraud. High-pressure salespeople promoting getrich-quick schemes sell more than three-fourths of all investment frauds over the telephone. With their slick sales pitches, con artists will try to cash in on just about any type of investment.

The techniques practiced by these swindlers are well rehearsed and often hard to resist.

Your best protection: Investigate before you invest.

To help you outsmart the con artist, the Department of Commerce & Consumer Affairs, through the Office of the Commissioner of Securities has prepared this brochure.

REMEMBER:

Before giving your money to anyone offering a "guaranteed investment," contact the Securities Enforcement Branch, (808) 586-2740. We cannot make the investment decision for you, but we have information that will help you to make an informed decision.

RISKY INVESTMENTS: BEWARE

Both legitimate brokers and con artists offer many investment opportunities. A legitimate investment can offer excellent returns, while a deal with a con artist is guaranteed to result in financial loss. Con artists commonly use the following techniques:

They promise a rate of return better than similar investments are paying.

They guarantee that the investment will not fail.

They insist that the opportunity to invest exists today only --- tomorrow will be too late.

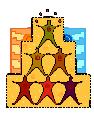
They promise to send someone to your home to pick up the funds today.

Investment scams are sold in many ways. The methods and promotions outlined in the following pages represent some of the most risky investment ventures; they are often illegal.



BOILER ROOMS:

These common unreliable operations display impressive-sounding addresses and use high-pressure salespeople to make thousands of unsolicited telephone calls to potential investors. The term "boiler room" describes the "heat" and high pressure generated by the callers, as they try to convince investors to send in their money. In most cases, either the company or the product does not exist, or does not operate as represented. If you receive an unsolicited call offering a deal that sounds too good to be true, be careful. It probably is not true, and you are talking to a con artist.



PONZI SCHEMES:

Con artists offer high rates of return on various impressive-sounding investments. However, instead of using the funds for investments, a portion of the original money is paid back to investors as their return. Satisfied investors then report these high returns to their friends, who in turn invest. In reality, there is no underlying business. The early investors are simply being paid with funds received from the later investors. When the scheme collapses, as it always does, current investors lose their money and the promoters walk away rich.



Pyramid Schemes

What Is A Pyramid Scheme? - Pyramid schemes are illegal moneymaking ventures for individuals, businesses, and small group of people. A typical pyramid scheme involves a few individuals at the top who recruit participants who, in turn, recruit other participants to offer something of value (usually money, but in some cases, time) to the organization. Recruits are offered the promise of large sums of money if they successfully bring in others to pay money to join the pyramid. Pyramid schemes focus on the exchange of money and recruitment. Usually, there is no legitimate product being sold.

How Are Pyramid Schemes Disguised? - Pyramid schemes may be disguised as games, chain letters, buying clubs, motivational companies, mail order operations, or investment organizations. Although some pyramid schemes call themselves multi-level marketing operations, not all multi-level marketing companies are pyramids. When the emphasis is on recruiting new members rather than selling something of value, the organization is probably an illegal pyramid.

How Do Pyramid Schemes Work? —Basically, a pyramid scheme is formed when a single promoter (or small group of promoters) collects money from a certain number of "friends" and instructs them to collect more money from more of their "friends." The cycle goes on from there. As the pyramid grows, the number of people involved becomes too large to sustain the pyramid. Some people will fail to send in their money or recruit the required number of "friends," and the pyramid crumbles. The majority of people end up on the "bottom" of the pyramid and inevitably will lose their initial "investment." They will not get their money back or earn their promised fortune because no one is beneath them in the pyramid adding new money to the pot.

Why Do Pyramid Schemes Fail? – Pyramid schemes collapse when a few people drop out or refuse to pay, and new members are not recruited in their place. In order for a pyramid scheme to profit, there would have to be a never-ending supply of potential (and willing) participants. In reality, however, the supply of participants is limited, and each new level of participants has a lesser chance of recruiting others and a greater chance of losing money.

How A Typical Pyramid Is Organized — A simple pyramid — for example, a five level program built on recruiting by fours — might work like this:

A new recruit would pay \$100 to "join" the organization.

That money would then be disbursed at regular intervals by the company - \$25 to the recruiter, \$25 to the company, and \$50 to the recruiter's "upline" in the form of \$10 payments to the recruiter's recruiter, and so on through five levels.

The new recruiter would recover the \$100 "fee" by recruiting four more people, each of whom would pay the recruiter \$25.

From this point, a participant would then make money from all recruiting done by the four recruits and their recruits.

Assuming successful recruiting by the four people down through each of five levels, a participant could (but probably never will) make a cumulative total of \$54,560:

- 1. \$160 on the first level e.g., four people each recruiting four others at \$10 a person (4x4=16x\$10=\$160);
- 2. \$640 on the second level e.g., 16 each recruiting four persons a \$10 each (16x4=64x\$10=\$640);
- 3. \$2,560 on the third level (64x4=256x\$10);
- 4. \$10,240 on the fourth level (256x4=1024x\$10);
- 5. \$40,960 on the fifth level (1024x4=4096x\$10).

Pyramid Reality

Pyramids are illegal. Because pyramid sales plans are by their very nature deceptive, they are illegal. There is a real risk that a pyramid operation will be closed down by police and the participants subject to fines and possible arrest.

Pyramids are deceptive. Participants in a pyramid, whether they mean to or not, are deceiving those they recruit. Few would pay to join if the odds stacked against them were fully explained.

Pyramids are losers. Pyramid schemes are based on simple mathematics: many losers pay a few winners.

Pyramids inevitably collapse because it is mathematically impossible to recruit the numbers of people required to support the pyramid. A nine-level pyramid, which is built when each participant gets six "friends" to join, would involve over ten million people!

6 36 216 1,296 7,776 46,656 279,936 1,679,616 10,077,696

Why Would Anyone Pay To Join A Pyramid?

Pyramid promoters are masters of group psychology. At recruiting meetings they create a frenzied, enthusiastic atmosphere where group pressure and promises of easy money play upon people's greed and fear of missing a good deal. It is difficult to resist this kind of appeal unless you recognize that the scheme is rigged against you.

Multi-level Marketing Companies

Multi-level marketing companies differ from pyramid schemes because they are usually legitimate business opportunities. The sale of legitimate products is what distinguishes multi-level marketing operations from pyramids.

If the emphasis in a multi-level marketing company is **to build a sale force rather than sell the company's products**, it may be an illegal <u>pyramid</u>.

The Difference Between Pyramid Schemes And Multi-level Marketing

Many pyramid promoters attempt to make their schemes look like a multi-level marketing company by using a line of near-worthless products or newsletters and claiming to be in the business of selling them. In pyramid schemes, little or no effort is made to actually market the products. Often there is not even an established market for the products. Rather the "sale" of such merchandise is used as a

front for the transactions, which occur only among, and between the operation's distributors.

In pyramid schemes, the emphasis in the sales pitch is on recruiting – building up the organization and the number of participants and on collecting the "start up" fee – not on selling the products. Pyramid schemes want to make money from you, not the product sales.

Pyramid schemes vs. Multi-level Marketing

Compensation based on recruiting vs. Compensation based on sales

Few or no sale to customers **vs.** Sell legitimate products to established markets

Substantial start-up costs vs. Generally small start-up fee

Potential to be stuck with large amounts of unsold goods vs. Will buy back unsold goods if you decide to quit the business

Make money from you vs. Make money with you

Protect Yourself

Take your time. Do not be rushed into any business deal. Show your attorney any contracts you receive from the company. A legitimate business opportunity will not disappear overnight.

Ask questions about the competency and experience of the company and its officers; the products, including the potential market in your area; start-up fees; buy-back provisions; and actual earnings of current distributors.

Get written copies of all available company literature.

Check with others who have experience with the company and its products. Find out if the products are actually being sold to customers.

Investigate and verify all information. Contact Business Registration Division of the Department of Commerce & Consumer Affairs, the Chamber of Commerce, or the Better Business Bureau if you suspect a company may be engaged in an illegal pyramid scheme.

If a pyramid promoter or recruiter tells you that the program has been examined and approved by the Business Registration Division or any other state agency, know that the claim is **not true!** Hawaii Business Registration Division, of the Department of Commerce & Consumer Affairs does not approve any marketing programs. If such representations are made to you, please notify the Division at (808) 586-2740.



DRILLING FOR RICHES

Oil and gas well interests are another common investment scam. By acquiring interests in a "proven" oil field or "surefire" wildcat well, investors are promised great riches. Often however, the wells do not exist or hold no further reserves. Watch out for deals on "orebearing" dirt that promise fantastic mineral reserves and profits. These deals may be illegal. Claims of a "secret" or "new" formula for removing valuable minerals from old mines signals a scam.



COINS AND PRECIOUS METAL SCHEMES

These schemes attempt to sell "investment grade" coins or gold, silver, and platinum bars and bullion. Con artists claim that the value of the coins or metals will increase dramatically in the future. However, if you send money, no coins or metals are shipped to you. Instead, you are told the coins and metals have been deposited in a vault or bank with an impressive name. Even if they have been deposited, their value is usually much less than was represented to you. The high commissions charged by the seller would require a great increase in the value of the coins of metals before you could break even. Worse yet, the coins or bullion may not even exist; the promoter may simply pocket your money.



MORTGAGES AND TRUST DEEDS

This type of transaction involves loaning money to someone who wishes to purchase or refinance real estate. The investor counts on receiving interest payments as the return on the investment, and expects to receive the title to the property if the borrower defaults. More often than not, the borrower is unable to repay the loan. The investor may discover that the property's value does not cover the investment or that the deed was not recorded in the investor's name.

EXOTIC INVESTMENTS

Investors are constantly approached to buy investments that are tied to recent technological developments or scientific breakthroughs. While such investments can be legitimate, often these opportunities are scams dressed in high-tech language. These schemes are designed to take advantage of investors' familiarity with news events.

These red flags should alert you to the possibility of a scam:

The details about the investment are obscure and confusing.

A fabulous rate of return is promised.

You are pressured to act immediately.

The person offering the investment opportunity is a stranger.



HOW CAN YOU INVESTIGATE

Before you invest, investigate the company, the salesperson, and the investment by asking questions and checking references.

You should thoroughly understand the investment **before** you invest. Do not be afraid to ask questions and write down the answers for future reference. Some of the most important questions you should ask the person selling the investment are:

What are your name, your firm's name, and your telephone number?

How did you get my name?

Are you and your firm licensed with the Business Registration Division of the Department of Commerce & Consumer Affairs to sell this investment?

What are the risks of this investment?

Can you send a prospectus or other offering document telling me the details of the investment? (Keep all written materials provided.)

How much commission are you receiving on this investment?

What statement or other documents will I get regarding this investment, and how often will they be received?

How do I liquidate my investment?

Smooth-talking con artists **will** have answers to your questions. They may or may not be true answers. Therefore, it is important that you do some further investigation by doing the following:

Call the local

Better Business Bureau

Or your local law enforcement agency to see if they have received any complaints about the company, the salesperson, or the investment.

Check with the Office of the Commissioner of Securities

By calling (808) 586-2722 to see if the firm or salesperson is licensed to sell investments in Hawaii. Also, ask if the investment is registered for sale in Hawaii.

Contact the

National Association of Securities Dealers

On their toll-free, hot line to get information about the firm and the salesperson.

1 (800) 289-9999. (9 a.m. to 5 p.m. EST)

Phone the Securities Enforcement Branch – DCCA

(808) 586-2740 from 7:45 a.m. to 4:30 p.m. to see if their office has received any complaints about the company.

Let us work together to stop investment fraud before con artists take another victim. Unfortunately, very few victims will ever again see a cent of their money. Swindling will continue as long as unscrupulous promoters prey on unwary investors.

The best way to stop investment fraud is to prevent it from occurring. Do not be afraid to ask questions and to investigate investment opportunities *before* you invest. The Office of the Commissioner of Securities of the State of Hawaii is here to help you. If you have questions about securities regulations or have encountered potential investment fraud, please call our office.

Community groups or organizations that want additional information or educational material about investment fraud may call our office, (808) 586-2740, or (808) 586-3976 and ask for the Securities Education Specialist. Public speakers are available. The Division also provides brochures on various investment-related topics.

Working together, we can prevent investment fraud.